United States Department of the Interior

MINERALS MANAGEMENT SERVICE
Royalty Management Program
P.O. Box 25165
Denver, Colorado 80225-0165

IN REPLY REFER TO:
AD/PSO/TSO 98-068-1/11
Mail Stop 3062

Mr. Jack J. Grynberg
Grynberg Petroleum Company
5000 South Quebec
Suite 500
Denver, Colorado 80237-2707

MAY 14 1998

Dear Mr. Grynberg:

This is in response to your February 9, 1998, Freedom of Information Act (FOIA) request (copy as Enclosure 1).

On February 20 you accepted an 8-page copy of an Order from Minerals Management Service to Shell Services Company dated August 28, 1995.

We are currently reviewing, identifying and deleting privileged and confidential information contained in the remainder of the documents that are responsive to your request. The complicated and sensitive nature of these materials requires that we consult with the submitter about their release. We anticipate completing the consultation process within two weeks, allowing us to fully respond to your request by June 3, 1998.

For your future reference, and in accordance with 43 CFR § 2.20(a)(1) (1997), we assess user fees to fulfill a FOIA request. Personnel charges cover our costs to conduct document searches and to review, identify, and delete privileged and confidential information. Other charges cover the direct costs of providing the material. Standard charges are:

Professional support	$18.60/hour	Computer/mag tapes	$25.00/each
Clerical support	$ 9.20/hour	CD-ROM	$ 6.00/each
Photocopies	$ .13/page	8 mm. tapes	$10.00/each
Microfiche	$ .08/page	Computer Diskettes	$ 1.25/each
Computer (CPU) time	$35.00/minute ($25.00 minimum)		

Fees for overdue bills include a $35 administrative charge plus interest at the prevailing Treasury rate.

If you have any questions, please contact Laurita Summerton at (303) 231-3628 or me at (303) 231-3013.

Sincerely,

Original Signed By
Gregory K. Kann
Gregory K. Kann
Freedom of
Information Act Officer

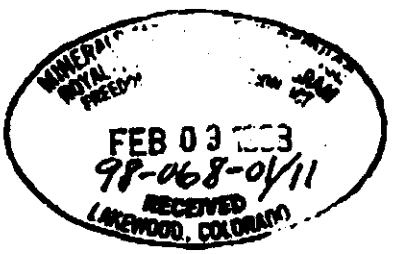
Enclosure

5000 SOUTH QUEBEC ● SUITE 500 ● DENVER, COLORADO 80237-2707, USA ● PHONE 303-850-7490

SPRINTMAIL X.400 (C:USA,A:TELEMAIL,O:MER1,UN:GRYNLDENVER) FAX: 303-850-7498

Via Fax #231-3781

February 9, 1998



Mr. Greg Kann
Minerals Management Service
Denver, Colorado 80225

Dear Greg:

Reference is made to the complaint filed by the Minerals Management Service against Shell Oil Company and possibly Mobil Oil Company as well, concerning underpayment of royalties for CO_2 production in the McElmo Dome Unit in Montezuma County, Colorado. I would appreciate receiving a copy of all the documents prepared by the MMS for the administrative proceedings, as well as the settlement of these proceedings between the MMS and Shell Oil Company and possibly Mobil Oil Company as well.

If the settlement includes a settlement with Cortez Pipeline, under the FOI Act I would like to obtain copies of all the material, including an audit by the MMS.

This letter is written on behalf of my wife, Celeste C. Grynberg, who is a trustee of the Rachel Susan Trust, the Stephen Mark Trust, and the Miriam Zela Trust. Rachel, Stephen and Miriam are our three children, who are overriding royalty owners of approximately 13,500 acres in the McElmo Dome Unit.

Sincerely yours,

GRYNBERG PETROLEUM COMPANY

Jack J. Grynberg
President

cc: Darren Nadel, Esq

United States Department of the Interior

MINERALS MANAGEMENT SERVICE
Royalty Management Program
P.O. Box 25165
Denver, Colorado 80225-0165

IN REPLY REFER TO:
AD/PSO/TSO 98-068-1/11
Mail Stop 3062

Mr. Jack J. Grynberg
Grynberg Petroleum Company
5000 South Quebec, Suite 500
Denver, Colorado 80237-2707

JUN 18 [illegible]

Dear Mr. Grynberg:

This is to follow up our May 14, 1998, response to your February 9 Freedom of Information Act (FOIA) request.

On February 20 you accepted an 8-page copy of an Order from Minerals Management Service to Shell Services Company dated August 28, 1995.

Enclosure 1 contains 133 pages of documents from the administrative proceedings that are responsive to your request. Since no settlement has been negotiated with Cortez Pipeline, we have no records that are responsive to that portion of your request.

Certain information in these materials has been withheld under FOIA Exemption 4. We have deleted specific details from contracts and settlements; certain prices, volumes, percentages, rates, costs, allowances; and tariff reimbursement amounts. Because you agreed to this withholding, we do not consider the deletions a partial denial under the FOIA.

Our policy, in keeping with the spirit of FOIA, is the prompt release of records to the greatest extent possible. At the same time, we must protect the rights of individuals and the administrative processes surrounding such rights. The FOIA regulations require us to withhold information protected under FOIA exemptions at 43 CFR § 2.13 (1996) when disclosure is prohibited by statute or Executive Order, or if sound grounds exist to apply an exemption.

We have determined that the deleted materials contain commercial and financial information and are privileged and confidential. This information is being withheld pursuant to Exemption 4 of FOIA, which exempts from disclosure ". . . trade secrets and commercial or financial information *obtained from a person and privileged or confidential.*" *We have replaced the deleted information* with the marking "X-4."

In accordance with 43 CFR § 2.20(a)(1) (1997), we assess user fees to fulfill a FOIA request. Personnel charges cover our costs to conduct document searches and to review, identify, and delete privileged and confidential information. Other charges cover the direct costs of providing the material. Standard charges are:

Professional support	$18.60/hour	Computer/mag tapes	$25.00/each
Clerical support	$ 9.20/hour	CD-ROM	$ 6.00/each
Photocopies	$ .13/page	8 mm. tapes	$10.00/each
Microfiche	$ .08/page	Computer Diskettes	$ 1.25/each
Computer (CPU) time	$35.00/minute ($25.00 minimum)		

G[illegible]

Fees for overdue bills include a $35 administrative charge plus interest at the prevailing Treasury rate.

Enclosure 2 is a bill for $222.83, the cost to fulfill your request.

If you have any questions, please contact Laurita Summerton at (303) 231-3628 or me at (303) 231-3013.

Sincerely,

Original Signed By
Gregory K. Kann

Gregory K. Kann
Freedom of
Information Act Officer

Enclosures

bcc: RM File (705-16)
RM Chron/Lkwd
MMS FOIA Officer, MS 2200 (e.t.)
RMP FOIA Officer, MS 3062
PSO Chron, MS 3060
TSO Chron, MS 3062
SICD FOIA Coordinator, MS 3660 (e.t.)
OE FOIA Coordinator, MS 3030 (e.t.)

LMS:RMP/AD/PSO/TSO:MS3062:LSummerton:06/12/98:231-3628:p:\FOIA98-068-1b.wp
Finalized:lpm:06/18/98

ENCLOSURE 1

STATE OF COLORADO

TAX AUDIT AND COMPLIANCE DIVISION
Department of Revenue

999 18th Street, Suite 1025
North Tower
Denver, Colorado 80202

Roy Romer
Governor

John J. Tipton
Executive Director

John Vecchiarelli
Division Director

December 12, 1991

Shell Oil Company
Jeannine Nieder SMT 2170B
P.O. Box 4655
Houston TX, 77210

Dear Ms. Nieder:

The Colorado Department of Revenue, in accordance with Section 205 of the Federal Oil and Gas Royalty Management Act of 1982 (FOGRMA), has reviewed, subject to the three scope limitations listed below, Shell Western Exploration and Producing Incorporated (SWEPI), Payor 49460, royalty payments for carbon dioxide (CO_2) produced from McElmo Dome unit Colorado Federal leases for the period of December 1, 1983 through September 30, 1989. The leases reviewed are attached as Exhibit A.

In the following three areas, the Department of Revenue review was limited, as stated below:

1) The review utilized the revised Exhibit B McElmo Dome unit acreage of 202,629.86. The use of this acreage in the audit findings is contingent upon final approval by the Bureau of Land Management.

2) The review utilized unconfirmed CO_2 prices supplied by Mobil for use in the Chevron and Total Unit weighted average price calculations. The use of these Mobil prices is contingent upon future audit confirmation.

3) Finally, for the time period March 1, 1988 through September 30, 1989 the review utilized the Cortez pipeline tariff of $0.39. The use of this $0.39 Cortez tariff is contingent upon the transportation allowance appeal currently in the MMS Royalty Valuations Standards Division.

This letter is intended to inform you of a preliminary royalty underpayment determination resulting from our review, and does not constitute a final action of determination by the Colorado Department of Revenue or Minerals Management Service (MMS). Its purpose is to give you an opportunity to provide additional documentation that would refute our preliminary determination.

Enclosure 2

BILL FOR COLLECTION

Bill No. 98-3020-072

Make Remittance Payable to: DOI/Minerals Management Service Date: 06/18/98

Mail Payment to: F&AMD, 381 Elden Street, Mail Stop 2300, Herndon, Virginia 20170-4817

Payor:

RE: FOIA Request No. 98-068-1/11

Mr. Jack J. Grynberg
Grynberg Petroleum Company
5000 South Quebec, Suite 500
Denver, Colorado 80237-2707

Amount of Payment $_____

Fees charged under the Freedom of Information Act:

Date	Description	Qty	Unit Price		Amount	
			Cost	Per		
06/18	Professional Support	10.5	$18.60/hr.		195	30
06/18	Clerical Support	1	$ 9.20/hr.		9	20
06/18	Photocopies	141	$ 0.13/pg.		18	33
	CPU Time		$35.00/minute $25.00/minimum			
	Tape/Cartridge*		$25.00/ea.			
	Less Credit for ReturnedTape*		($25.00)/ea.			
	Due Date: 07/17/98					

Note: A one-time $35.00 administrative charge, plus a .42 percent late charge of $.94 for each 30-day period or portion thereof, will be assessed for overdue bills.

*Magnetic tapes may be returned for a credit toward your next request. However, we will not process a cash refund.

AMOUNT DUE THIS BILL	$222	83

APPROPRIATION NUMBER 142419.1

United States Department of the Interior

MINERALS MANAGEMENT SERVICE
Royalty Management Program
P.O. Box 25165
Denver, Colorado 80225-0165

AUG 28 1996

IN REPLY REFER TO:

MMS/SICD 6-8-33
MS 3660

3-20005.546
Colorado
Shell

Asouthall 8/22/96
PBMiller 8/22/96

CERTIFIED MAIL --
RETURN RECEIPT REQUESTED

Mr. Donald J. Vial
Shell Services Company
P.O. Box 4772, Room 7207 WCK
Houston, Texas 77210-4772

Dear Mr. Vial:

The Colorado Department of Revenue (State), in accordance with Section 205 of the Federal Oil and Gas Royalty Management Act of 1982 (FOGRMA), has reviewed Shell Western Exploration and Producing Inc.'s (SWEPI), Payor Code 49460, royalty computations for carbon dioxide (CO_2) produced from various Colorado Federal leases located within the McElmo Dome Unit, for the period of October 1, 1989, through September 30, 1992. The State has specifically reviewed the issue of tax reimbursements not previously addressed in the demand letter dated September 27, 1995. The leases reviewed are identified on Enclosure 2.

The State's review concludes that SWEPI is entitled to receive severance tax reimbursements on the contracts listed below. In addition, SWEPI is entitled to ad valorem reimbursements according to contract dated April 1, 1989, between X-4 X-4 as operator of the Wasson ODC Unit, and X — 4 ——X——4——. The tax reimbursements are due as a result of the severance and ad valorem tax rates increasing above the base period rate. The State details in Enclosure 1, page 1, that SWEPI was entitled to receive a total of X — 4 regarding severance and ad valorem tax reimbursements which should be included in the calculation of the McElmo Dome weighted average prices.

SWEPI was notified of these findings by issue letter dated May 3, 1996, and SWEPI responded by letter dated May 30, 1996. The State reviewed the response and addressed it as follows:

I. Royalty on Severance Tax Reimbursements

In response to the subject issue stated below and in the issue letter, SWEPI does not contest the preliminary determination that

such tax reimbursements should be included in the calculation of the McElmo Dome Unit weighted average prices upon which royalties are paid.

Federal regulations and instructions from the Minerals Management Service (MMS) establish the value used in calculating royalties due from Federal leases. Title 30 CFR § 206.152(h) (1989) states, in part:

> . . . under no circumstances shall the value of production for royalty purposes be less than the gross proceeds accruing to the lessee for lease production . . .

In addition, the MMS' position on tax reimbursements has been upheld in court in Hoover & Bracken Energies v. U.S. Department of the Interior, 723 F.2d 1488 (10th Cir. 1983) cert. denied, 469 U.S. 821 (1984).

SWEPI made deliveries under the following CO_2 purchase contracts that contained tax reimbursement provisions:

The CO_2 purchase contracts dated November 19, 1984, and November 19, 1987, between Shell Western E&P and X-4, used to value the third party deliveries to Meters 74221-501 and 502, respectively, state, in part:

> Buyer shall, subject to the conditions hereinafter set forth, pay Seller X-4 of any additional tax. The term "additional tax" shall mean any sales, transaction, occupation, service, production, severance, gathering, transmission, value-added or excise tax, assessment of fee levied, assessed or fixed by governmental authority and taxes of a similar nature or equivalent in effect (not including income, excess profits, capital stock, franchise or general property taxes) in respect of or applicable to the carbon dioxide delivered hereunder to Buyer in addition to or greater than those, if any, being levied, assessed or fixed on October 1, 1984, and for which Seller may be liable, either directly or indirectly, or through any obligation to reimburse others.

The CO_2 purchase contract dated January 1, 1982, between Shell Oil Company (as operator of the Denver Unit) and X-4

X-4, used to value the delivery to the Denver Unit, Meter 74222-500A, states, in part:

> Buyer shall, subject to the conditions hereinafter set forth, pay Seller, X-4 of any additional tax. The term "additional tax" shall mean any sales,

> transaction, occupation, service, production, severance, gathering, transmission, value-added or excise tax, assessment of fee levied, assessed or fixed by governmental authority and taxes of a similar nature or equivalent in effect (not including income, excess profits, capital stock, franchise or general property taxes) in respect of or applicable to the carbon dioxide delivered hereunder to Buyer in addition to or greater than those, if any, being levied, assessed or fixed on the date of this Contract and for which Seller may be liable, either directly or indirectly, or through any obligation to reimburse others.

The CO_2 purchase contract dated April 1, 1989, between X-4 and X-4 used to value the In-kind delivery to the Wasson ODC Unit, Meter 74222-502A, states, in part:

> Buyer agrees to reimburse Seller for (i) X - 4 of any increased production or severance taxes or other taxes which may be imposed after January 1, 1990, and which are required to be paid by Seller, applicable to Seller's purchase of CO_2 delivered and/or deliverable hereunder, (ii) X - 4 of any and all other new Taxes, legally imposed on, and required to be paid by Seller after January 1, 1990, by Federal, State, and/or Local Government authorities on CO_2 delivered and/or deliverable hereunder, and/or on the transportation, storage, transfer, or sale of CO_2 hereunder . . .

The CO_2 purchase contract dated November 17, 1984, between SWEPI and X - 4 used to value the third party delivery to the Wasson ODC Unit, Meter 74222-502B, states, in part:

> Subject to the conditions hereinafter set forth, Buyer shall pay to Seller X - 4 of any additional tax. The term "additional tax" shall mean any sales, transaction, occupation, service, production, severance, gathering, transmission, value-added or excise tax, assessment of fee levied, assessed or fixed by governmental authority and taxes of a similar natureor equivalent in effect (not including income, excess profits, capital stock, franchise or general property taxes) in respect of or applicable to the Carbon Dioxide delivered hereunder to Buyer, in addition to or greater than those, if any, being levied, assessed or fixed on March 1, 1984, and for which Seller may be liable, either directly or indirectly, or through any obligation to reimburse others.

The CO_2 purchase contract dated March 1, 1989, between SWEPI and X - 4 used to value the third party

delivery to the Wasson ODC Unit, Meter 74222-502C, states, in part:

> Subject to the conditions hereinafter set forth, Buyer shall pay to Seller X - 4 of any additional tax. The term "additional tax" shall mean any sales, transaction, occupation, service, production, severance, gathering, transmission, value-added or excise tax, assessment of fee levied, assessed or fixed by governmental authority and taxes of a similar nature or equivalent in effect (not including income, excess profits, capital stock, franchise or general property taxes) in respect of or applicable to the Carbon Dioxide delivered hereunder to Buyer, in addition to or greater than those, if any, being levied, assessed or fixed on February 1, 1989, and for which Seller may be liable, either directly or indirectly, or through any obligation to reimburse others . . .

The CO_2 purchase contract dated July 12, 1985 between SWEPI and X - 4 used to value the third party delivery to the McElmo Creek Unit, Meter 74236-FM2, states, in part:

> Buyer shall, subject to the conditions hereinafter set forth, pay Seller X - 4 of any additional tax. The term "additional tax" shall mean any sales, transaction, occupation, service, production, severance, gathering, transmission, value-added or excise tax, assessment of fee levied, assessed or fixed by governmental authority and taxes of a similar nature or equivalent in effect (not including income, excess profits, capital stock, franchise or general property taxes) in respect of or applicable to the carbon dioxide delivered hereunder to Buyer in addition to or greater than those, if any, being levied, assessed or fixed on March 15, 1954, and for which Seller may be liable, either directly or indirectly, or through any obligation to reimburse others.

The CO_2 purchase contract dated April 1, 1992, between SWEPI and X - 4 used to value the deliveries to the Dollarhide Field, Meter 74222-507A, states, in part:

> Subject to the conditions hereinafter set forth, Buyer shall pay to Seller X - 4 of any additional tax. The term "additional tax" shall mean any sales, transaction, occupation, service, production, severance, gathering, transmission, value-added or excise tax, assessment of fee levied, assessed or fixed by governmental and/or regulatory authority and taxes of a similar nature or equivalent in effect (not including income, excess profits, capital stock,

> franchise or general property taxes) in respect of or applicable to the Carbon Dioxide delivered hereunder to Buyer in addition to or greater than those, if any, being levied, assessed or fixed on December 31, 1991, and for which Seller may ultimately be liable . . .

The CO_2 purchase contract dated April 1, 1992, between SWEPI and X-4 used to value the deliveries to the Dollarhide Field, Meter 74222-507B, states, in part:

> Subject to the conditions hereinafter set forth, Buyer shall pay to Seller ——X— 4 —— of any additional tax. The term "additional tax" shall mean any sales, transaction, occupation, service, production, severance, gathering, transmission, value-added or excise tax, assessment of fee levied, assessed or fixed by governmental and/or regulatory authority and taxes of a similar nature or equivalent in effect (not including income, excess profits, capital stock, franchise or general property taxes) in respect of or applicable to the Carbon Dioxide delivered hereunder to Buyer, in addition to or greater than those, if any, being levied, assessed or fixed on December 31, 1991, and for which Seller may ultimately be liable . . .

Finally, the CO_2 purchase contract dated March 1, 1988, between SWEPI (as operator) and X-4 used to value the deliveries to the South Cross Field, Meter 74221-509A and 509B, states, in part:

> Subject to the conditions hereinafter set forth, Buyer shall pay to Seller X 4 of any additional tax. The term "additional tax" shall mean any sales, transaction, occupation, service, production, severance, gathering, transmission, value-added or excise tax, assessment of fee levied, assessed or fixed by governmental authority and taxes of a similar nature or equivalent in effect (not including income, excess profits, capital stock, franchise or general property taxes) in respect of or applicable to the Carbon Dioxide delivered hereunder to Buyer, in addition to or greater than those, if any, being levied, assessed or fixed on September 1, 1987, and for which Seller may be liable, either directly or indirectly, or through any obligation to reimburse others.

The State has concluded that SWEPI is entitled to receive Severance tax reimbursements on the contracts listed above. In addition, SWEPI is entitled to ad valorem reimbursements according to the contract dated April 1, 1989, between X-4 and X-4 The tax reimbursements are due as a result of the severance and ad valorem tax rates increasing above the base period rate.

II. Weighted Average Pricing for CO_2

SWEPI and the State disagree on the value of CO_2. The State has reviewed and adjusted the subject calculations to reflect SWEPI's computations with regards to CO_2 valuation. The subject issue has been resolved.

In conclusion, SWEPI does not disagree that the tax reimbursements due under the cited contracts should be included in the calculation of the weighted average prices. Regarding the value of CO_2 for royalty purposes, the State agrees with SWEPI's computations; therefore, no differences exist.

In order to bring royalty payments and procedures for the Colorado Federal leases within the McElmo Dome Unit into compliance with Federal regulations and lease terms for the period October 1, 1989, through September 30, 1992, SWEPI is directed to:

(1) Recalculate weighted average prices relating to SWEPI, Chevron, and Small Share Working Interest Owners (total unit price) with regards to the aforementioned tax reimbursements.

(2) Recalculate and report additional royalties using the determined weighted average prices in Item #1.

Within 90 days from receipt of this order, Shell is also directed to remit all payments to MMS. Your payment should be tendered in accordance with the regulations at 30 CFR § 218.51 (1995) and accompanied by an appropriately completed green Form MMS-2014 (forms enclosed) using adjustment reason code 40. The green Form MMS-2014 must reflect finding control number $x-4$ in block 3a "Payor-Assigned Document Number." If you have any questions concerning the instructions for completing the green Form MMS-2014, please contact your Royalty Reporting and Payments Branch representative at (303) 231-3872. Appropriate late payment charges pursuant to 30 CFR § 218.202 (1995) will be computed and billed to Shell upon receipt of payment of the additional royalties due.

Copies of the adjusting Form(s) MMS-2014's and other supporting schedules should be sent to:

Mr. F. David Loomis
Colorado Department of Revenue
Mineral Audit Section
Suite 400
400 South Colorado Boulevard
Denver, Colorado 80222

All documentation supporting your compliance with this order are subject to audit, and therefore, should be retained by Shell until MMS completes its follow-up compliance testing. Shell should continue to value production in accordance with regulations and guidelines discussed in this order. If in the future MMS determines that the royalty payments do not comply with this order, the violation may be willful.

Section 109 of FOGRMA, promulgated in 30 CFR § 241.51 (1995), authorizes MMS to assess civil penalties for failure or refusal to comply with the requirements of FOGRMA or any statute, regulation, rule, order, lease, or permit. Consequently, your failure to comply with the terms of this order may be considered a violation pursuant to 30 CFR § 241.51(a)(3) and could subject you to penalties of up to $5,000 per violation per day for each day the violation continues.

You have the right to appeal this order in accordance with the provisions of 30 CFR Part 290 (1995). Any appeal taken will be to the Director, MMS, and the notice of appeal must be filed within 30 days from the date of receipt of this order at the following address:

Mr. James R. Detlefs, Chief
State and Indian Compliance Division
Minerals Management Service
P.O.Box 25165, Mail Stop 3660
Denver, Colorado 80225-0165

Any notice of appeal shall incorporate or provide by separate letter written statement of reasons, as you deem adequate, to justify reversal or modification of this directive. You have 90 days from receipt of this letter to file any statement of reasons or written briefs to explain your appeal. Time extensions for filing the statement of reasons must be in writing and demonstrate good cause for the time extension. Furthermore, the written request for the time extension must be provided to the Division Chief at the address shown above for approval.

In accordance with the provisions of 30 CFR § 243.2 (1995), compliance with this order will be suspended upon a timely appeal, pending the outcome of the appeal.

If you have any questions concerning this matter, please call Mr. Richard Pond of the Colorado Department of Revenue at

(303) 355-0400, extension 779 or Mr. Armand Southall of MMS at (303) 275-7487.

Sincerely,

ORIGINAL SIGNED BY:
JAMES R. DETLEFS

Mr. James R. Detlefs
Chief, State and Indian Compliance Division

3 Enclosures

bcc: Chief, HCD
J. Twomey, State of California
W. Fleming, State of Montana
G. Staigle, State of North Dakota
J. Norman, State of New Mexico
DADC Chron
SICD File
SICD Chron
RM Chron Lkwd/DC (2)
LMS:DADC:SICD:MS3660:ASouthall:dvh:8/19/96:303-275-7487:6-8-33
Final:dvh:8/22/96

STATE OF COLORADO

TAX AUDIT AND COMPLIANCE DIVISION
Department of Revenue

999 18th Street, Suite 1025
North Tower
Denver, Colorado 80202

Roy Romer
Governor

John J. Tipton
Executive Director

John Vecchiarelli
Division Director

December 12, 1991

Shell Oil Company
Jeannine Nieder SMT 2170B
P.O. Box 4655
Houston TX, 77210

Dear Ms. Nieder:

The Colorado Department of Revenue, in accordance with Section 205 of the Federal Oil and Gas Royalty Management Act of 1982 (FOGRMA), has reviewed, subject to the three scope limitations listed below, Shell Western Exploration and Producing Incorporated (SWEPI), Payor 49460, royalty payments for carbon dioxide (CO_2) produced from McElmo Dome unit Colorado Federal leases for the period of December 1, 1983 through September 30, 1989. The leases reviewed are attached as Exhibit A.

In the following three areas, the Department of Revenue review was limited, as stated below:

1) The review utilized the revised Exhibit B McElmo Dome unit acreage of 202,629.86. The use of this acreage in the audit findings is contingent upon final approval by the Bureau of Land Management.

2) The review utilized unconfirmed CO_2 prices supplied by Mobil for use in the Chevron and Total Unit weighted average price calculations. The use of these Mobil prices is contingent upon future audit confirmation.

3) Finally, for the time period March 1, 1988 through September 30, 1989 the review utilized the Cortez pipeline tariff of $0.39. The use of this $0.39 Cortez tariff is contingent upon the transportation allowance appeal currently in the MMS Royalty Valuations Standards Division.

This letter is intended to inform you of a preliminary royalty underpayment determination resulting from our review, and does not constitute a final action of determination by the Colorado Department of Revenue or Minerals Management Service (MMS). Its purpose is to give you an opportunity to provide additional documentation that would refute our preliminary determination.

Our review indicates that, during the audit period, SWEPI underpaid royalties due the MMS by $897,892.00. It appears that SWEPI underpaid royalties as a result of these issues:

ISSUE	AMOUNT
CO_2 Price Valuation Issues Contract Pricing & Transportation Deduction	$ 827,677.46
Royalty on Severance Tax Reimbursements	$ 70,214.54
	$ 897,892.00

Each of these issues will be discussed in detail.

CO_2 Price Valuation Issues

Federal regulations and instructions from MMS establish the value used in calculating royalties and also allow the Secretary of the Department of the Interior latitude in setting guidelines for allowing transportation deductions. Title 30 of the Code of Federal Regulations (CFR) Section 206.103 (1986), entitled "Value basis for computing royalties.", states in part:

> The value of production, for the purpose of computing royalty, shall be the estimated reasonable value of the product as determined by the Associate Director due consideration being given to the highest price paid for a part or for a majority of production of like quality in the same field, to the price received by the lessee, to posted prices and to other relevant matters.

Furthermore, the new regulations effective *March 1, 1988, Title 30 CFR Section* 206.152(c)(1) (1989), provides guidelines for valuing gas sold pursuant to a non arms-length contract. The first benchmark for determining reasonable value states:

> The gross proceeds accruing to the lessee pursuant to a sale under its non-arms-length contract (or other disposition other than by an arm's-length contract), provided that those gross proceeds are equivalent to the gross proceeds derived from, or paid under, comparable arm's-length contracts for purchases, sales, or other dispositions of like-quality gas in the same field (or, if necessary to obtain a reasonable sample, from the same area). In evaluating the comparability of arm's-length contracts for the purposes of these regulations, the following factors shall be considered: price, time of execution, duration, market or markets served, terms, quality of gas, volume, and such other factors as may be appropriate to reflect the value of the gas.

In addition, the MMS Royalty Valuations Standards Division (RVSD) has established policy for valuing In-kind CO_2 deliveries. For In-kind deliveries the MMS has determined that the applicable royalty value should be the delivery point, unit operators, principal CO_2 purchase contract price less actual cost of transportation (Limited to 50% of the products unit value).

The authority of the Secretary (or the Secretary's designated delegate) to determine the reasonable value of gas is reinforced in the Notice to Lessees No.1 (NTL-1), Section III., relating to gas and associated liquids, which states in part:

> The value of all produced gas and associated liquid hydrocarbons will be established by the Supervisor. Such value will be based on the Supervisor's estimated reasonable value of both the natural gas and its entrained liquid hydrocarbons with due consideration being given to the highest price paid for a part or a majority of like quality production in the same field or area, to the price(s) received by the operator, to the Btu content of the gas, and to other relevant matters. Under no circumstances will the royalty value be computed on less than the gross proceeds accruing to the operator from the sale of such leasehold production. Gross proceeds include, but are not limited to, tax reimbursement and payments to the operator for gathering, measuring, compressing, dehydrating, or performing other services necessary to market the production. Likewise, no deduction will be allowed for the cost which an operator occurs by reason of placing the gas in a marketable condition as an operator obligated to do so at no cost to the lessor.....(Emphasis added)

Section III. of NTL-1 also shows that the NTL is intended to apply to sales of carbon dioxide gas by stating in part:

> ...Non-hydrogen byproducts such as sulfur and carbon dioxide which are extracted for sale must also be reported in the same manner on the monthly Form 9-361....

The broad authority possessed by the Secretary to determine the appropriate method of calculating allowed transportation allowances has been noted by the Interior Board of Land Appeals. In Shell Oil Company, 52 IBLA 15 (Decided January 15, 1981) 88 I.D. 1, the IBLA stated, in part, that:

> ...The Secretary of the Interior has discretionary authority to determine the factors to be considered in computing transportation allowances for royalty valuation purposes....

The Conservation Division Manual (CDM), a procedural guide of the U.S. Geological Survey (USGS), predecessor agency to MMS, addresses transportation allowance guidelines. The CDM Section 647.5.3E (1974) addresses the maximum allowable transportation allowance and states in part that:

> ...However, when the transportation cost is greater than 25 percent of the fair market value at the nearest competitive sales terminal, the Supervisor must conduct a complete review prior to approval of such rates. Under no circumstances should transportation costs exceed 50 percent of the product's fair market value at the nearest competitive sales point...

Finally, the new regulations effective March 1, 1988, Title 30 CFR Section 206.156(c)(1) (1989), entitled "Transportation Allowances-General", states in part:

> ...For unprocessed gas valued in accordance with section 206.152 of this subpart, the transportation allowance deduction on the basis of a selling arrangement shall not exceed 50 percent of the value of the unprocessed gas...

SWEPI has incorrectly calculated its SWEPI, Chevron, and Total Unit weighted average prices, for the periods January 1984 through September 1989. This has resulted, because of four contract pricing errors (four separate deliveries) and exceeding the transportation deduction limitation of 50 percent of unit value (10 separate deliveries). The contract pricing and transportation issues will be elaborated upon below:

Denver Unit In-kind Delivery Meter 74222-500B

The Colorado Department of Revenue has determined that the applicable price for this delivery should be the contract dated January 1, 1982, between X-4 ——— ———X-4 ——— (This contract was determined to be Arms-length by MMS RVSD). This contract is considered to be the unit operators principal CO_2 purchase contract as it accounts for approximately 60 percent of the total CO_2 delivered to the Denver unit.

Wasson ODC In-kind Delivery Meter 74222-502A

The Colorado Department of Revenue has determined that the applicable price for this delivery should be the contract dated November 1, 1984, between ——X-4—— ·———— X-4 and the seller X-4 (This contract was determined to be Arms-length by MMS RVSD). This contract is considered to be the unit operators principal CO_2 purchase contract, as it accounts for approximately 63 percent of the total unit's CO_2 requirement.

South Wasson Clearfork In-kind Delivery Meter 74222-509

SWEPI has erred by not properly including the correct tariff reimbursement pricing terms. The contract for valuing this delivery is dated June 30, 1986, between X-4 ——— X-4 ———— The price terms addressing the transportation reimbursement, state in part:

> Buyer agrees to reimburse Seller for a transportation charge, F.O.B. Denver City, Texas as set out below: Tariff reimbursement of $ X-4 (1986), $X-4 (1987), $ X-4 (1988) and $X-4 (1989)

SWEPI improperly utilized a transportation reimbursement of $0.39, the amount of the Cortez tariff.

McElmo Creek Third Party Meter 74236-FM2

The applicable contract for valuing this delivery is the contract dated July 12, 1985, between ———— X-4 ———— SWEPI has erred as a result of not properly converting the price to the contract stated pressure base of 14.73 PSIA.

Transportation Deduction Limitation

SWEPI has incorrectly taken a transportation deduction, exceeding 50 percent of the products unit value, on ten separate deliveries. As previously mentioned, the CDM Section 647.5.3E., and the Code of Federal Regulations 30 CFR Section 206.156(c)(1), state that under no circumstances should the transportation cost exceed 50 percent of the products fair market value.

These price valuation issues all affect the calculation of the SWEPI, Chevron and Total Unit weighted average prices and have resulted in SWEPI underpaying royalties by $827,677.46. **SEE Exhibit B Schedules**

Royalty on Severance Tax Reimbursements

Federal regulation and instructions from the MMS establish the value to be used in calculating royalties due from Federal leases. 30 CFR 206.103 (1986) and the new regulations 30 CFR 206.152(h) (1989) effective March 1,1988, states in part that royalty is due on the "...gross proceeds accruing to the lessee...".

Section 3 of the Notice to Lessees and Operators No.1 (NTL-1) states in part:

> "Under no circumstances will the royalty value be computed on less than the gross proceeds accruing to the operator from the sale of such leasehold production. Gross proceeds include, but are not limited to, tax reimbursement and payment to the operator for gathering, measuring, compressing, dehydrating, or performing other services necessary to market the production. (Emphasis added.)"

In addition, the MMS position on tax reimbursements has been upheld in court in Hoover & Bracken Energies v. United States Department of the Interior, et al, 723 F.2d 1488 (1983).

Furthermore, the CO2 purchase contracts used to value the deliveries to meters 74221-501 and 502, dated November 14, 1984 and November 19, 1987, between ——— X – 4 ——— respectively state in part:

> Buyer shall, subject to the conditions hereinafter set forth, pay Seller X-4 of any additional tax. The term "additional tax" shall mean any sales, transaction, occupation, service, production, severance, gathering, transmission, value-added or excise tax, assessment of fee levied, assessed or fixed by governmental authority and taxes of a similar nature or equivalent in effect (not including income, excess profits, capital stock, franchise or general property taxes) in respect of or applicable to the carbon dioxide delivered hereunder to Buyer in addition to or greater than those, if any, being levied, assessed or fixed on October 1, 1984, and for which Seller may be liable, either directly or indirectly, or through any obligation to reimburse others.

The CO_2 purchase contract, used to value the delivery to the Denver unit, Meter 74222-500A, dated January 1, 1982, between — X - 4 — states in part:

> Buyer shall, subject to the conditions hereinafter set forth, pay Seller X-4 of any additional tax. The term "additional tax" shall mean any sales, transaction, occupation, service, production, severance, gathering, transmission, value-added or excise tax, assessment of fee levied, assessed or fixed by governmental authority and taxes of a similar nature or equivalent in effect (not including income, excess profits, capital stock, franchise or general property taxes) in respect of or applicable to the carbon dioxide delivered hereunder to Buyer in addition to or greater than those, if any, being levied, assessed or fixed on the date of this contract and for which Seller may be liable, either directly or indirectly, or through any obligation to reimburse others.

The CO_2 purchase contract, used to value the In-kind delivery to the Wasson ODC unit, Meter 74222-502A, dated November 1, 1984, between X-4 and X-4 states in part:

> Buyer agrees to reimburse Seller for (i) any increased production or severance taxes or other taxes which may be imposed after January 1, 1983, and which are required to be paid by Seller, applicable to Seller's purchase of CO_2 delivered and/or deliverable hereunder, (ii) any and all other new taxes, legally imposed on, and required to be paid by Seller after June 1, 1984, by Federal, State, and/or Local Government authorities on CO_2 delivered and/or deliverable hereunder, and/or on the transportation, storage, transfer, or sale of CO_2 hereunder.

The CO_2 purchase contract, used to value the third party delivery to the Wasson ODC unit, Meter 74222-502B, dated November 17, 1984, between X-4 and X-4 — X-4 — states in part:

> Subject to the conditions hereinafter set forth, pay Seller X - 4 of any additional tax. The term "additional tax" shall mean any sales, transaction, occupation, service, production, severance, gathering, transmission, value-added or excise tax, assessment of fee levied, assessed or fixed by governmental authority and taxes of a similar nature or equivalent in effect (not including income, excess profits, capital stock, franchise or general property taxes) in respect of or applicable to the carbon dioxide delivered hereunder to Buyer in addition to or greater than those, if any, being levied, assessed or fixed on March 1, 1984, and for which Seller may be liable, either directly or indirectly, or through any obligation to reimburse others.

The CO_2 purchase contract, used to value the third party delivery to the McElmo Creek unit, Meter 74236-FM2, dated July 12, 1985, between X-4 and X-4 states in part:

> Buyer shall, subject to the conditions hereinafter set forth, pay Seller X-4 of any additional tax. The term "additional tax" shall mean any sales, transaction, occupation, service, production, severance, gathering, transmission, value-added or excise tax, assessment of fee levied, assessed or fixed by governmental authority and taxes of a similar nature or equivalent in effect (not including income, excess profits, capital stock, franchise or general property taxes) in respect of or applicable to the carbon dioxide delivered hereunder to Buyer in addition to or greater than those, if any, being levied, assessed or fixed on March 15, 1984, and for which Seller may be liable, either directly or indirectly, or through any obligation to reimburse others.

Finally, the CO_2 purchase contract, used to value the deliveries to the South Cross Field, Meter 74221-509A and 509B, dated March 1, 1988, between X-4 X-4 states in part:

> Subject to the conditions hereinafter set forth, pay Seller X-4 of any additional tax. The term "additional tax" shall mean any sales, transaction, occupation, service, production, severance, gathering, transmission, value-added or excise tax, assessment of fee levied, assessed or fixed by governmental authority and taxes of a similar nature or equivalent in effect (not including income, excess profits, capital stock, franchise or general property taxes) in respect of or applicable to the Carbon Dioxide delivered hereunder to Buyer in addition to or greater than those, if any, being levied, assessed or fixed on September 1, 1987, and for which Seller may be liable, either directly or indirectly, or through any obligation to reimburse others.

The State has determined that SWEPI is entitled to receive Severance tax reimbursements on the contracts listed above. This is a result of the Severance taxes on the McElmo Dome unit production increasing above and beyond the base period tax. Therefore, SWEPI has underpaid royalties by $70,214.54 as a result of not including Severance tax reimbursements in their royalty calculations. **SEE Exhibit C Schedules**

Shell Western Exploration is requested to review the factual information outlined in this letter and in the enclosed exhibits and schedules. You are requested to advise this office no later than January 21, 1992 of your concurrence or the specified reason(s) for your disagreement with the findings outlined in the schedules. Any correspondence should be addressed to:

Mr. F. David Loomis, Manager
Mineral Audit Section
Colorado Department of Revenue
999 Eighteenth Street
Suite 1025, North Tower
Denver, Colorado 80202
Telephone: 303-294-5110

If you desire to voluntarily comply with the contents of this issue letter, your adjustments must be accompanied by a green Form *MMS-2014* (copies attached). Instructions for completing this form are also attached. If you have any questions concerning this letter or audit schedules, please contact Michael Santos at (303) 294-5128.

Sincerely,
MINERAL AUDIT SECTION

F. David Loomis
Manager

FDL:MS:sc

enclosures:

cc: Shell Audit File
Issue Letter File
Correspondence File

United States Department of the Interior

MINERALS MANAGEMENT SERVICE
ROYALTY MANAGEMENT PROGRAM
P.O. BOX 25165
[illegible]

IN REPLY
REFER TO:

RECEIVED
SEP 2 1992
COLORADO DEPARTMENT OF REVENUE
MINERAL AUDIT

AUG 27 1992

MMS/RCD/OSTPS 2-8-96
MS 3601

2-05133.000
Colorado
Shell Oil Co.

Memorandum

To: Chief, Division of Appeals

Through: Chief, Royalty Compliance Division — Original Signed By JESSE EDWARDS for

From: Chief, Office of State and Tribal Program Support — Original Signed David S. Guzy

Subject: Request for Docket on Notice of Appeal by Shell Oil Company on FBIL 22924004, Colorado Department of Revenue

Attached are Shell Oil Company's (Shell) Notice of Appeal and Statement of Reasons on Appeal dated August 25, 1992. Shell is appealing an order issued by Minerals Management Service on July 22, 1992. This Notice represents all arguments put forth by Shell. We request that a docket number be assigned.

The audit was performed by the Colorado Department of Revenue (State) in accordance with Section 205 of the Federal Oil and Gas Royalty Management Act of 1982. Written response to the Notice of Appeal has been requested from the State as required by contract. Our office will transmit the appropriate field report after we receive the required input from the State. If you need further information, please call Patrick Milano at (303) 969-6659.

Attachment

bcc: F.D. Loomis, State of Colorado
RCD Chron
RCD/STP File
RCD/STP Chron
RCD:OSTPS:MS3601:PMilano:dvh:8/26/92:FTS321-6659:STP:2-8-96
Final:dvh:8/27/92

United States Department of the Interior

MINERALS MANAGEMENT SERVICE
ROYALTY MANAGEMENT PROGRAM
P.O. BOX 25165
DENVER, COLORADO 80225

TAKE PRIDE IN AMERICA

IN REPLY
REFER TO:

MMS/RCD/OSTPS 2-8-95
MS 3601

2-05133.000

AUG 27 1992

RECEIVED

AUG 31 1992

COLORADO DEPT OF REVENUE
MINERAL AUDIT

CERTIFIED MAIL --
RETURN RECEIPT REQUESTED

Mr. F. David Loomis
Colorado Department of Revenue
Mineral Audit Section
999 18th Street
Suite, 1025, North Tower
Denver, Colorado 80202

Dear Mr. Loomis:

Enclosed are Shell Oil Company's final documents supporting its appeal from an order issued by Minerals Management Service on July 22, 1992. Please review these documents which concern FBIL 22924004, and provide the Office of State and Tribal Program Support with your written report concerning the substance of the appellant's arguments.

If you should have any questions about this matter, please call Mr. Patrick Milano at (303) 969-6659.

Sincerely,

David S. Guzy, Chief
Office of State and Tribal
Program Support

Enclosure

Shell Oil Company

200 North Dairy Ashford
Houston, TX 77079

P.O. Box 576
Houston, TX 77001-0576

August 25, 1992

EXPRESS MAIL

Mr. David S. Guzy, Chief
Office of State and Tribal Program Support
Royalty Compliance Division
Minerals Management Service
P. O. Box 25165, Mail Stop 3601
Denver, Colorado 80225-0165

SUBJECT: MMS/RCD/OSTPS 2-4-87
NOTICE OF APPEAL
AUDIT OF FEDERAL LEASES
MC ELMO DOME UNIT
DOLORES AND MONTEZUMA COUNTIES, COLORADO

Dear Mr. Guzy:

Shell Oil Company ("Shell"), on behalf of its subsidiary Shell Western E&P Inc. ("SWEPI"), hereby timely files its Notice of Appeal with respect to the letter of the Minerals Management Service ("MMS") dated July 22, 1992, and received by Shell on July 27, 1992, directing SWEPI to pay additional royalties for the subject federal leases in the amount of $908,631.35 for the period December 1, 1983 through September 30, 1989 ("the audit period").

INTRODUCTION

This Notice of Appeal sets forth SWEPI's objections to the findings of the MMS with respect to underpayment of royalty at the Denver Unit In-Kind Delivery Meter 74222-500B. In addition, SWEPI sets forth its objections as to royalty underpayments prior to July 22, 1986 as being precluded by the applicable statute of limitations.

SWEPI does not dispute the MMS' findings of royalty underpayments with respect to the Wasson ODC In-Kind Delivery Meter 74222-502A, the South Wasson Clearfork In-Kind Delivery Meter 74222-509, the McElmo Creek Third Party Meter 74236-FM2, the royalty on severance tax reimbursements, and the transportation deduction limitations. However, with respect to the transportation deduction limitation, SWEPI has filed a Request For Exception Relief dated March 31, 1992 requesting retroactive relief to March 1, 1988. Therefore, SWEPI's concurrence with the MMS' findings is subject to its pending Request for Exception Relief. SWEPI has elected to post a letter of credit in the amount of $1,638,000 by the invoice due date in order to suspend its compliance with the MMS' order pending this appeal. The data set forth

in Attachment No. 5 is confidential proprietary data and should not be released by the MMS to third parties.

STATEMENT OF REASONS SUPPORTING NOTICE OF APPEAL

1. The July 1, 1986 contract for the sale of CO_2 by X-4 to the Denver Unit is an arm's length contract negotiated four years after the initial sale of CO_2 to the Denver Unit. Because of declining CO_2 prices between 1982 and 1986, the 1986 contract is the arm's length contract to be taken into consideration for purposes of valuing in-kind deliveries of CO_2 by X-4 from Denver Unit In-Kind Delivery Meter 74222-500B.

2. A portion of the December 1, 1983 through September 30, 1989 audit period is beyond the applicable statute of limitations (28 U.S.C. § 2415(a)).

ARGUMENT

1. DENVER UNIT IN-KIND DELIVERY METER 74222-500B

SWEPI has entered into two separate contracts to supply McElmo Dome Unit CO_2 to the Denver Unit in Texas. The first of these contracts is dated January 1, 1982 and provided that X-4 would provide X-4 MCF/d to the Denver Unit at an initial cost of $ X-4 per MCF on January 1, 1982 (subject to crude oil adjustment provisions), and transportation costs pursuant to the Cortez Pipeline tariff. The January 1, 1982 contract also provided a take-or-pay clause applicable to X-4 MCF/day of the contract volume. By letter dated September 10, 1984, the MMS determined that the January 1, 1982 contract was acceptable to the MMS for establishing a value for royalty purposes (Attachment No. 1). Deliveries of CO_2 under the January 1, 1982 contract commenced in April 1984.

In November 1985, Conoco, the second largest working interest owner in the Denver Unit, requested SWEPI, as operator of the Denver Unit, to renegotiate the January 1, 1982 contract to permit the Denver Unit working interest owners to obtain a more competitive price for CO_2 than then existed under the January 1, 1982 contract. During the period between 1982 and 1986 both oil and gas prices had declined dramatically. As a result of the declining oil prices, the demand for CO_2 to use in tertiary recovery projects had also declined substantially. On January 23, 1986, SWEPI balloted the Denver Unit working interest owners concerning this matter (Attachment No. 2). The Denver Unit working interest owners directed SWEPI to limit CO_2 purchases under the January 1, 1982 contract to the take-or-pay volume (X-4 MCF/day) and to negotiate a new sales contract and/or supply in-kind contracts for the required CO_2 in excess of the take-or-pay volume. A bid letter dated March 31, 1986 was developed by Conoco and Texaco, on behalf of the Denver Unit, and was sent by SWEPI, as operator, to potential CO_2 suppliers (Mobil, ARCO, Exxon, Amoco, and SWEPI) (Attachment No. 3). Only X-4 and X-4 submitted bids to supply the needs of the Denver Unit. By letter dated June 1, 1986, Conoco and Texaco, acting as administrators of the Denver Unit CO_2 supply proposal, recommended that negotiations should be conducted with respect to X-4 offer of May 9, 1986 (Attachment No. 4). Such negotiations resulted in the July 1, 1986 contract between

X-4 and the Denver Unit. This contract is the second of the two contracts under which X-4 supplies CO_2 to the Denver Unit. As one might expect, the July 1, 1986 contract provides for a lower price for CO_2 than does the January 1, 1982 contract.

SWEPI's share of the gas purchased by the Denver Unit under the July 1, 1986 contract is supplied pursuant to an In-Kind Delivery contract and is valued at the price of CO_2 under the July 1, 1986 contract. The MMS contends that the applicable price for CO_2 delivered-in-kind by SWEPI should be based on the price in the January 1, 1982 contract. The basis for such contention is that the January 1, 1982 contract (1) is accepted by the MMS as an arm's length contract, (2) is considered to be the unit operator's principal contract since it accounts for approximately 60 percent of the total CO_2 purchased by the Denver Unit, and (3) has the highest price. The MMS contends that the July 1, 1986 contract is not an arm's length contract, and covers less than 20 percent of the CO_2 purchased by the Denver Unit. In addition, the MMS contends that the July 1, 1986 contract was executed after the date of the CO_2 in-kind contract being valued.

The procedures for negotiating the July 1, 1986 contract were virtually identical to the procedures followed in negotiating the January 1, 1982 contract, which the MMS has accepted for purposes of establishing royalty value. In each instance X-4 X-4 found itself in a situation of selling CO_2 to the Denver Unit, of which X-4 X-4 for the Denver Unit and having the other major working interest owners negotiate an arm's length contract with X-4 This procedure was found acceptable with respect to the January 1, 1982 contract and we have no doubts that had the July 1, 1986 contract also been submitted for acceptance by the MMS, the same result would have occurred. The July 1, 1986 contract contains a price negotiated between X-4 as seller, and the remaining working interest owners, as buyers. Obviously, it would have been to X-4 advantage to maintain the January 1, 1982 contract price in effect for all CO_2 purchased by the Denver Unit, but, in fact, it was required to renegotiate a lower price for all volumes not subject to take-or-pay in the January 1, 1982 contract. The result is an arm's length contract.

The federal regulations provide procedures for valuing CO_2 under arm's length contracts. Prior to March 1, 1988, the value of the CO_2 was the estimated reasonable value, due consideration being given to the highest price paid for a part or for a majority of production of like quality in the same field, to the price received by the lessee, to posted prices, and to other relevant matters. In the absence of good reason to the contrary, value computed on the basis of highest price per MCF paid or offered at the time of production for the major portion of like quality CO_2 will be considered to be a reasonable value. (30 CFR § 206.103 (1985)).

Subsequent to March 1, 1988, the value of CO_2 which is sold pursuant to arm's length contracts is the gross proceeds accruing to the lessee. (30 CFR § 206.152(b)(1)(i)(1988)).

It is SWEPI's contention that its in-kind deliveries of CO_2 to the Denver Unit to satisfy its share of CO_2 purchase obligations under the July 1, 1986 contract should be valued in accordance with

such contract. Just as it would be improper for SWEPI to value all of its share of CO_2 deliveries to the Denver Unit at the July 1, 1986 contract price, it is also improper for the MMS to value all of SWEPI's in-kind deliveries at the January 1, 1982 contract price.

The MMS' insistence on valuing SWEPI's in-kind deliveries of CO_2 based on the January 1, 1982 contract ignores the decline in CO_2 prices from 1982 to 1986. However, Congress addressed this concern in the Notice to Lessees Numbered 5 Gas Royalty Act of 1987, P. L. 100-234, 101 Stat. 1719 (1988) ("NTL-5 Act"). The NTL-5 Act modified Section II.A.2 of NTL-5, which was applicable to the sales of CO_2 from the McElmo Dome Unit to the Denver Unit, by providing that the standard of basing valuation on the majority price for a field would not be followed if there was good reason to the contrary to not do so. The following colloquy between Senators Melcher, Johnston, and McClure during the debate on the NTL-5 Act made it clear that dramatically dropping CO_2 prices during the 1982-1986 period constituted good reason to the contrary:

> The legislation [NTL-5 Act] provides, as do the regulations in Title 30, Code of Federal Regulations, that absent good reason to the contrary, the highest price paid for a major portion of the production from a field or area is a reasonable value. It is my understanding that during the period covered by this [NTL-5 Act], gas prices were falling and many sellers were forced to accept lower prices, often the result of so-called market-out clauses. Am I correct that this market circumstances is "good reason to the contrary" such that under this legislation, MMS could, and in most cases should, accept as royalty value contract prices which were dictated by the market and which would be lower than the highest price paid for a major portion of production?
>
> Mr. JOHNSTON. That is my understanding.
>
> Mr. MC CLURE. I would also answer that question affirmatively.

133 Cong. Rec. 518631 (December 21, 1987). (Emphasis added).

In most cases, and as was the case here, an arm's length contract will establish value. SWEPI contends that because of the declining market for CO_2 during the 1982-1986 period, the MMS should have accepted the July 1, 1986 contract as representing the value of CO_2 at such time the contract was entered into.

The MMS also argues that the July 1, 1986 contract (Delivery Meter 74222-500C) covers less than 20 percent of the CO_2 requirements of the Denver Unit. Although this is correct, it should be irrelevant in the determination of which CO_2 contract to use for determination of the value of SWEPI's in-kind deliveries. The July 1, 1986 contract was limited in volumes only because of the take-or-pay obligation applicable to $X - 4$ MCF/day under the January 1, 1982 contract (Delivery Meter 74222-500A). Unless the requirement for CO_2 at the Denver Unit grows, the total deliveries under the July 1, 1986 contract together with the in-kind deliveries are limited

to a maximum of approximately 40 percent of the Denver Unit requirements. Valuation based strictly upon the fact that one particular contract provides the major portion of production does not adhere to the guidance of Congress under the NTL-5 Act. Market circumstances are clearly a good reason to avoid relying blindly on the major portion contract, and to base valuation on a more contemporaneously executed contract reflecting the changed market circumstances.

The MMS also contends that during the audit period there were no arm's length contracts covering sales to the Denver Unit (other than the ~~x~~ ~~4~~ March 1, 1983 contract, which was really a sale to SWEPI for one-third of the volumes to be delivered under the January 1, 1982 contract) on which it could value the in-kind deliveries by SWEPI. The MMS apparently fails to realize that a CO_2 sales contract with a particular unit for tertiary recovery generally is for the unit's total requirements of CO_2 during the tertiary recovery project. Only one such contract is usually required. SWEPI contends that the MMS should direct its attention not to the purchasing unit, but should look at arm's length sales of CO_2 from the source field to other purchasers in order to compare arm's length contracts for CO_2 during the relevant time period. Attachment No. 5 reveals the arm's length sales of CO_2 from the McElmo Dome Unit by SWEPI during the period between the January 1, 1982 Denver Unit contract and the July 1, 1986 Denver Unit contract. This Attachment clearly reveals the decline in CO_2 prices that occurred during this period. A comparison of these arm's length contract prices supports SWEPI's contention that there was good reason to the contrary for the MMS to abandon its highest price for a major portion standard and for the MMS to accept the July 1, 1986 contract price as the value of SWEPI's in-kind deliveries.

Finally, the MMS contends that the July 1, 1986 contract for the Denver Unit was executed after the date of the in-kind delivery contract that is being valued. The in-kind delivery contract was dated March 1, 1986. Although it did precede the July 1, 1986 contract, it was clearly associated with the efforts of the Denver Unit working interest owners to negotiate a new sales contract for the volumes of CO_2 required in excess of the January 1, 1982 contract take-or-pay volumes. The volumes of CO_2 delivered under both the March 1, 1986 contract and the July 1, 1986 contract, together with certain in-kind deliveries by other Denver Unit working interest owners valued at the July 1, 1986 price, constitute the total CO_2 requirements of the Denver Unit in excess of the January 1, 1982 contract. Valuation of the March 1, 1986 in-kind delivery contract should be measured by the terms of the July 1, 1986 contract.

2. STATUTE OF LIMITATIONS

Section 2415(a) of Title 28 of the United States Code governs the time for commencing actions brought by the United States or agency thereof which are founded upon contract. This general statute of limitations provides in pertinent part as follows:

> Subject to the provisions of section 2416 of this title, and except as otherwise provided by Congress, every action for money damages brought by the United States or an officer or agency thereof which is founded upon any contract express or implied in law or fact, shall be barred unless the complaint is filed within six years after the right of action accrues or within one year after final decisions have

> been rendered in applicable administrative proceedings required by contract or by law, whichever is later . . . .

The MMS and its predecessor, the United States Geological Survey, have previously interpreted its audit powers consistent with the six year statute of limitations contained in 28 U.S.C. § 2415(a). The internal guidelines and procedures for audits contained in the USGS Conservation Division Manual recognized that audits must be conducted on all leases within six years because of the six year statute of limitations in 28 U.S.C. § 2415(a). See Release No. 30 dated March 7, 1977 and Release No. 57 dated October 26, 1979.

In ***Foote Mineral Company***, GAS-5-Mining, dated September 17, 1976, the Acting Director of the USGS held that the practical effect of the six year statute of limitations, 28 U.S.C. § 2415(a)(1970), is to preclude the Survey from billing appellant for royalties which accrued more than six years prior to the date of the letter notifying Foote that his royalty calculations were in error. On appeal, the Interior Board of Land Appeals ("IBLA"), although acknowledging that 28 U.S.C. § 2415(a) (1970) was applicable to an action to pursue remedies, held that such limitations period was not applicable to administrative proceedings to determine underlying obligations for royalty. 34 IBLA 285, dated April 17, 1978. However, the IBLA decision in ***Foote Mineral Co.***, ***supra***, was reversed by the United States Court of Claims in ***Foote Mineral Co. v. The United States***, 654 F.2d 81 (1981). This case was an action by Foote to recover royalties paid to the United States Geological Survey from 1966 to 1974 on sodium and potassium pursuant to federal leases issued to Foote. In 1974, the USGS claimed additional royalties were due. At that time, Foote determined that lithium, the mineral actually being produced from the property, was not subject to payment of royalties. The court held the sodium and potassium leases were invalid and Foote was entitled to recover the royalties previously paid to the USGS. Interestingly, the court noted that "the [USGS'] answer asserts that the statute of limitations bars any recovery for royalties paid prior to January 8, 1972. The parties have not yet addressed this issue and may do so on remand. We express no opinion on this matter." ***Id.*** at 88. Thus, the Secretary continues to acknowledge and attempt to utilize the six year statute of limitations as a bar to recovery of royalty payments.

In ***Coastal Oil and Gas Corp.***, MMS-87-0015-O&G dated March 25, 1987, the MMS Assistant Director for Program Review cited 28 U.S.C. § 2415(a) as providing the MMS six years to file a right of action for late payment charges. The MMS decision stated that it is the policy of the U.S. Government to assess a late payment charge on all debts not received by the due date. The decision points out that the due date of royalty payments, the last day of the month next following the month of production, is well settled. Thus, this decision of the MMS recognizes that its right of action accrues on the royalty due date. This same holding was made by the court in ***Phillips Petroleum Co. v. Manuel Lujan, Secretary of the Department of the Interior, et al.***, (N.D. Okla. October 18, 1989, W.L. 239616); reversed on other grounds and remanded, 951 F.2d 257 (10th Cir. 1991).

In ***Phillips***, ***supra***, the court held that the six year statute of limitations set forth in 28 U.S.C. Section 2415(a) is applicable to claims for royalty pursuant to an oil and gas lease between the

federal government as lessor, and a lessee. The court also held that the six year statute of limitations begins to run when the royalty was due or paid.

There is no express statute of limitations applicable to claims by the MMS for additional royalty from Federal leases. In fact, Congress must have had in mind the general statute of limitations with respect to claims for money damages arising out of contract when it enacted the Federal Oil and Gas Royalty Management Act ("FOGRMA"), 30 U.S.C. § 1701, et seq. (1982). The limitations period in FOGRMA for maintaining records for royalty audit by the MMS is consistent with the six year limitations period in the general statute.

FOGRMA also has its own six year statute of limitations with respect to recovery of penalties under the Act. 30 U.S.C. § 1755. The court in ***Phillips***, ***supra***, found that it is appropriate to presume that Congress, in enacting FOGRMA, was acting with a generalized understanding how the general statute of limitations would operate in an action to enforce royalty rights.

MMS cites ***Forest Oil Corp.***, 111 IBLA 284 (1989) for the proposition that the statute of limitations does not accrue when the royalty was underpaid, but accrues only when the MMS reasonably knew of the underpayment. The MMS claims that its contention is supported by 28 U.S.C. § 2416(c), an exception to 28 U.S.C. § 2415(a).

Section 2416(c) of Title 28 provides that for the purpose of computing the limitations period established in Section 2415(a), there shall be excluded all periods during which facts material to the right of action are not known and reasonably could not be known by an official of the United States charged with the responsibility to act in the circumstances.

Section 2416(c) of Title 28 is inapplicable with respect to tolling the six year statute of limitations under the facts here, since the MMS could have known of its right of action by timely auditing SWEPI's records. The six year statute of limitations began to run when the royalty payment was due or made. The fact that the MMS did not bring its action until the audit was completed does not toll the statute of limitations. In ***United States of America v. Gavilan Joint Community College District, et al.***, 849 F.2d 1246 (9th Cir. 1988) the court held that uncertainty as to the exact amount of the claim does not constitute lack of knowledge of a fact "material to the right of action." The court noted that the legislative history of Section 2416(c) of Title 28 expressly states that the principal application of the Section 2416(c) exclusion from the running of the statute of limitations was intended for situations involving fraud. The material facts that are not known must go to the very essence of the right of action. 1966 U.S. Code Congressional and Administrative News 2502, 2508.

The MMS also contends that the six-year statute of limitations applies to the judicial enforcement of administrative actions, but not to the administrative actions themselves. However, in ***Phillips***, supra, the District Court denied the federal defendant's motion to dismiss on grounds that the MMS order was not final agency action and therefore not subject to judicial review.

The Court held that inasmuch as the MMS order did not provide for a stay pending review, Phillips was not required to exhaust its administrative remedies, and the MMS order constituted

final agency action subject to judicial review. The MMS did not appeal the denial of its motion to dismiss. In ***Phillips***, the Tenth Circuit held as follows:

> Defendants were not asserting a claim for underpayment of royalties. Had they been, plaintiff might have very well been able to assert a statute of limitations defense. See 28 U.S.C. 2415 (six-year statute of limitations on "action for money damages brought by the United States...which is founded upon any contract).

Therefore, the MMS demand letter to SWEPI dated July 22, 1992, which requires calculation of and payment of royalties, is subject to a six-year statute of limitations defense. Accordingly, SWEPI asserts that the MMS is barred by the applicable statute of limitations from asserting a demand for payment of royalties from SWEPI from the subject federal leases prior to July 22, 1986.

CONCLUSION

For the foregoing reasons, SWEPI respectfully requests that the MMS accept the July 1, 1986 arm's length contract with the Denver Unit as the proper basis for valuing deliveries of CO_2 by SWEPI under the Denver Unit In-Kind Delivery Meter 74222-500B. SWEPI also respectfully requests that the MMS directive to pay additional royalties to the MMS be limited to the period July 22, 1986 through September 30, 1989.

Respectfully submitted,

William G. Riddoch

William G. Riddoch
Senior Counsel
On behalf of Shell Western E&P Inc.
(713) 870-3625

WGR:NC

cc: Mr. F. David Loomis, Manager
Mineral Audit Section
Colorado Department of Revenue
999 Eighteenth Street
Suite 1025, North Tower
Denver, CO 80202

Attachment No. 1

United States Department of the Interior

MINERALS MANAGEMENT SERVICE
ROYALTY MANAGEMENT PROGRAM
P.O. BOX 25165
DENVER, COLORADO 80225

IN REPLY
REFER TO
MMS-RVS-OG-83-374
M.S. 653

RECEIVED
SEP 17 1984

SEP 10 1984

ENCLOSURE CONTAINS COMPANY
PROPRIETARY INFORMATION
FOR U.S. GOVERNMENT USE ONLY

X-4

By letter dated April 9, 1984, MMS requested ——— X-4 ——— to submit additional information regarding the arm's-length nature of a contract to sell carbon dioxide (CO_2) produced from the McElmo Dome Unit in Montezuma and Delores Counties, Colorado to the Denver Unit in Yoakum and Gaines Counties, Texas.

MMS received the information from X-4 by letter dated June 5, 1984. MMS has reviewed the information and found that all items of concern have been answered satisfactorily.

MMS has determined that the contract between ——— X ——— 4 ——— X-4 dated January 1, 1982 is acceptable. The pricing terms contained in your contract to sell CO_2 to the Denver Unit are acceptable to MMS for establishing a value for royalty purposes.

A copy of our Findings and Conclusions is enclosed for your information.

You have the right to appeal any of the decisions in this letter in accordance with the provisions of Title 30, Code of Federal Regulations Part 290. Any appeal taken will be to the Director, Minerals Management Service, and the notice of appeal must be filed with

Minerals Management Service
Attention: Mr. William H. Feldmiller
Chief, Royalty Valuation and Standards Division
P. O. Box 25165, Mail Stop 653
Denver, CO 80225

within 30 days from the date of receipt of this letter.

A copy of your appeal should be forwarded to:

Mr. Norman Hess
Appeals Division
Minerals Management Service
Mail Stop 623
12203 Sunrise Valley Drive
Reston, Virginia 22091
Telephone (703)860-7251

If you have any questions regarding this matter, please call us at (303)231-3546.

Sincerely,

William H. Feldmiller
Chief, Royalty Valuation and
Standards Division

Enclosure

Attachment No. 2

Shell Western E&P Inc.
A Subsidiary of Shell Oil Company

P.O Box 576
Houston, TX 77001

January 23, 1986

ALL WORKING INTEREST OWNERS
DENVER UNIT

Gentlemen:

PURCHASED CO_2 FOR DENVER UNIT

In response to Conoco's letter of November 6, 1985, Shell Western E&P Inc. (SWEPI) has prepared the attached ballot relating to future purchases of CO_2 for the Denver Unit. In essence, SWEPI seeks to determine Working Interest Owners' (WIO) desire to:

1. Limit CO_2 purchases under the existing contract to the Daily Contract Quantity (DCQ), i.e., X-4 MMSCF/D during the contract year.

2. Negotiate a new purchase contract and/or a supply in-kind agreement for the X-4 MMSCF/D CO_2 in excess of the DCQ.

If the ballot is approved, all WIO will be responsible for providing their share of the X-4 MMSCF/D. All WIO's must then elect one of the follcwing options:

A. Supply in-kind CO_2 which meets the Denver Unit quality specifications.

B. Request SWEPI (as operator of the Denver Unit) to handle the bidding to select a CO_2 supplier.

The effective date for implementing these items will be the date ballot approval is received. We realize that alternate supplies of CO_2 cannot be arranged instantly, and we have asked our current seller of CO_2 for a proposal to supply volumes of CO_2 in excess of the contract take-or-pay on an interim basis. A copy of seller's response is attached. This arrangement will cover a 90-day period commencing with ballot approval. SWEPI, as operator of Denver Unit, believes this proposal to be fair and equitable to all WIO.

In order to insure an uninterrupted supply of CO_2 to Denver Unit at the design rate of X-4 MMSCF/D, any WIO who elects to supply-in-kind must begin deliveries within 90 days of ballot approval. Any WIO who elects to supply-in-kind and does not commence deliveries within 90 days will automatically be included in the new contract for their share of volumes in excess of the DCQ.

Please return the completed ballot to:

Shell Western E&P Inc.
ATTN J. H. Sheffield
Engineering Manager
CO_2 Ventures - Western Division
P. O. Box 576
Houston, Texas 77001

Any questions you may have should be addressed to J. H. Sheffield, 713/870-3394.

Yours very truly,

J. H. Sheffield
Engineering Manager
CO_2 Ventures - Western Division

RRW:lc

Attachment

DENVER (SAN ANDRES) UNIT
SHELL WESTERN E&P INC. - OPERATOR
JANUARY 1986

BALLOT FOR LIMITING CURRENT CO_2 CONTRACT TO DCQ AND PROVIDING FOR ALTERNATE SUPPLY.

1. Limit CO_2 purchased under current contract to DCQ and negotiate new sale/purchase contract and/or supply in-kind agreement for CO_2 in excess of DCQ.

   ___ For

   ___ Against

2. If approval of item 1 is obtained, our share of CO_2 in excess of DCQ will be supplied:

   ___ In-kind

   ___ By a supplier selected by bid. Operator to conduct the bid selection process.

APPROVED BY _____

TITLE _____

FOR _____

DATE _____

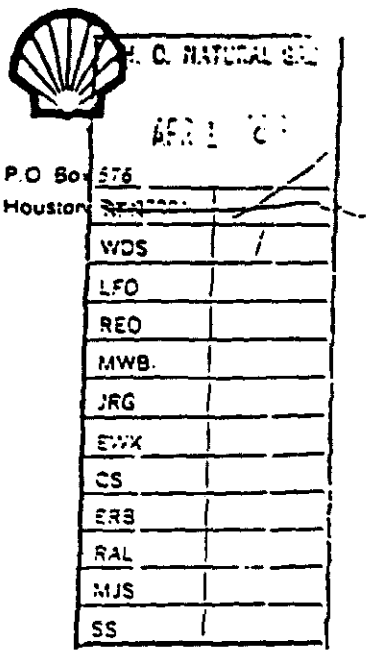
Please return signed copy of this ballot to:

Shell Western E&P Inc.
ATTN J. H. Sheffield
Engineering Manager
CO_2 Ventures - Western Division
P. O. Box 576
Houston, Texas 77001

BNBY8601503

Attachment No. 3

Shell Western E&P Inc.
A Subsidiary of Shell Oil Company



March 31, 1986

Shell Oil Company
ATTN R. F. Nelson
P. O. Box 2463
Houston, Texas 77001

Gentlemen:

SUBJECT: CARBON DIOXIDE SUPPLY
DENVER UNIT - WASSON (SAN ANDRES) FIELD
GAINES AND YOAKUM COUNTIES, TEXAS

Shell Western E&P Inc. (SWEPI), as Operator of the Denver Unit, desires to solicit bids for third party CO_2 supply to supplement volumes currently supplied by SWEPI to the unit. Texaco and Conoco, the largest WIO's to purchase CO_2 in the Unit, have jointly developed this bid letter on behalf of the Unit. These supplemental volumes are those above the current take obligation (X-4 MMCFD) and have no take obligation associated with them. An approved bid for supplemental volumes would have to provide more favorable price and terms than the current contract.

Information and requirements for this proposal are as follows:

1. Delivery Point - At or near the downstream flange of the Denver Unit meter facility, located in SW/4 Section 827, Block D, John H. Gibson Survey, Yoakum County, Texas.

2. Volume - Approximately X-4 MMCFD will be required for the life of this contract with an additional ——— X-4 ——— MMCFD) needed during the first six month period of the contract. The additional six month volume will be needed to repay SWEPI for volumes supplied during an interim ninety day period. Total purchasing requirements will be approximately X-4 BCF.

3. Term - X-4 years or until X-4 BCF is purchased, whichever occurs first.

4. Price - Should be based on a zero percent take or pay. If any take or pay obligations are included, then an economic out clause should be inserted if the working interest owners vote to shut the project down or reduce injection volume to X-4 MMCFD. The formula tying the price of CO_2 to crude should include a weighting factor (less than one) to reduce the rise in CO_2 prices when crude oil is increasing.

   More specifically, the price of CO_2 should be quoted at a fixed, non-escalating price for a period of time and determined by a formula thereafter. As an example, a commodity price of $.40 for CO_2 should be tied to a January 1, 1986 crude price. A lower commodity price will be tied to a lower crude price. One suggested formula is as follows:

Total laid-in CO_2 cost = Base Price $(WF \times \frac{Pi}{P2} \div (1-WF)) + T$

Base Price = $.40/MCF
WF = Weighting factor (less than 1.0)
Pi = Current crude price
P2 = Crude price (January 1, 1986)
T = Transportation

5. Delivery Point specifications

- Minimum pressure of X-4 psig, maximum of X-4 psig.

- Minimum purity - X-4 mol percent pure CO_2.

- No -X- 4 - and no more than X-4 water vapor per MMCF at psia and X-4

- Temperature no greater than X-4 F.

- No more than X-4 parts by weight of hydrogen sulphide per X-4 parts of CO_2.

6. Transportation - Per pipeline tariff with ceiling for maximum annual escalation.

7. First Delivery - June 1, 1986

In view of their majority position as purchasers, Conoco and Texaco will be administering the bid solicitation procedure. After bid review and any subsequent negotiations, a recommendation will be made to the Denver Unit Working Interest Owners if any acceptable bids are found. If recommended, a new purchase contract could then be consummated after the Working Interest Owners determine it is desirable to do so. If you have any questions or comments about this proposal, please call Bob Leibrecht with Conoco at 713/293-1804 or Bill Graham with Conoco at 713/293-3086. Detailed proposals are due by April 30, 1986 and should be sent to:

Conoco Inc.
ATTN Mr. A. M. Yarsa
Division Manager, Midland Division
P. O. Box 1959
Midland, Texas 79702-1959

Yours very truly,

M. L. Blanton
Division Production Manager
Western Division

CB:lc

Wasson Denver Unit
Prop S/P (Conoco)
4/86

Pricing

$$\text{Delivered Price} = P\left(WF \times \frac{X-4}{X-4} + (1-WF)\right) + T$$

Let: $P = X-4$ ¢/mcf

$T = X-4$ ¢/MCF

Then: $\text{Delivered Price} = X-4\left(WF \times X-4 + (1-WF)\right) + X-4$

WF	Commodity Price	Delivered Price	ALTERNATE! Commodity Price	ALTERNATE! Delivered Price
1.0	X-4	X-4	X-4	X-4
0.9	↓	↓	↓	↓
0.5	↓	↓	↓	↓
0.1	↓	↓	↓	↓
0.0	↓	↓	↓	↓

Attachment No. 4 (COP CO)

William L. Graham
Coordinator, Pipeline Gas Marketing
Natural Gas Department

Conoco Inc.
P.O. Box 2197
Houston, TX 77252
(713) 293-3086

CO_2 BUSINESS DEVELOPMENT
DATE RECD. 6/3

1	CPS		
	DSB		
	DWN		GLK
	TDK		CFH

June 2, 1986

X-4

Gentlemen:

Conoco and Texaco, acting as administrators of the Denver Unit carbon dioxide supply proposal, have recommended to SWEPI that negotiations should commence with X-4 to finalize the contract for carbon dioxide supply. The following items concerning the May 9, 1986 X-4 proposal are submitted for your review:

1. Article 1.1 (h) Definitions - "Initial Annual Period" should begin July 1, 1986.

2. Article 3.1 Commencement of Deliveries - June 1, 1986 should be changed to July 1, 1986

3. Article 3.2 Take-or-Pay - The cover letter for this proposal to A. M. Yarsa dated May 9, 1986 states "No take-or-pay payment as long as purchased total project volumes from X-4 MMCFD to and including X-4 MMCFD are purchased under this contract." For clarity the following language is recommended:

   "From and after the date of the beginning of the Initial Annual Period, during each Period Buyer agrees to purchase and take from Seller or to pay for if not taken an annual quantity of Carbon Dioxide equal to the sum of a daily quantity, hereinafter referred to as the "Daily Take-or-Pay Quantity", in effect on each day of the applicable period. The Daily Take-or-Pay Quantity shall be equal to the quantity (limited to X-4 MMCF per day) made available to certain Working Interest Owners of the Denver Unit under this contract for injection volumes over X-4 MMCFD per day. Quantities of carbon dioxide herein made available shall be that portion of the Denver Unit requirements as provided by multiplying Buyer's unit participation (as set forth in Exhibit A) times volumes over X-4 MMCF per day but limited toX-4 MMCF per day." This language would replace the first two sentences in Article 3.2.

4. Article 3.4 Makeup Rights - Makeup language is unnecessary and can be left out.

5. Article 3.6 Cooperation Regarding Deliveries - "...that Seller's inability to conform its deliveries to Buyer's revised daily requirements shall not have the effect of reducing the Daily Contract

Quantity otherwise applicable," should be eliminated because it is not consistent with current Take-or-Pay language.

6. Eliminate 3.7 Contract Volumes Proportionate to Unit Participation of Buyer.

7. Article 3 - Language should be added to allow makeup of carbon dioxide volumes supplied by SWEPI during March, April and May, 1986. This language would address Buyer's right to take volumes up to X-4 of Daily Contract Quantity during the first six months of this contract.

8. Article 4.1 Initial Price and Adjustments - Should reflect current market price and P1 should be changed to X-4 MCF from the stated X-4 MCF. June 1, 1986 should be changed to July 1, 1986.

9. This proposal provides unilateral protection in various places to the Seller in case of inability to perform. Language should also be included to protect the Buyer. This language should be:

   a. Article 4.1 Initial Price and Adjustments - The floor of X-4 per MCF should be eliminated to provide protection to the Buyer if the price of crude should drop below $ X-4 BBL. If the price does drop below $X-4, then price would be determined by the formula outlined in the original contract dated January 1, 1982.

   b. Article 13.2 Buyer's Termination Option - A Buyer termination provision should be added stating that if the Denver Unit decides to reduce injection volumes to X-4 MMCF per day or less on a permanent basis, the Buyer can terminate this contract with no further obligation.

10. Article 4.4 Tax Reimbursement - January 1, 1985 should be changed to January 1, 1986.

11. Article 4.5 Excess Royalty - Eliminate "or basis".

12. Article 10.2 Extended Force Majeure 365 days should be changed to 90 days.

Conoco and Texaco would like to meet with X-4 the week of June 2, 1986 to discuss these items and finalize this contract.

Very truly yours,

W. L. Graham

lsh

cc: A. M. Yarsa, Midland
R. J. Leibrecht, Houston
W. G. Robb, Houston
W. F. Stone, Texaco

WLG2-00025

Attachment No. 5

Mc Elmo Dome Unit CO_2 Contracts

Purchase Location	Date of Contract	Initial Delivery	Current Delivered Price $/MCF	Current Netback Price $/MCF
Denver Unit	1/1/82	4/84	X-4	X-4
Big Three Pre 1988	12/3/84	1/86	X-4	X-4
Willard	5/24/85	4/86	X-4	X-4
E. Vacuum	8/1/85	9/85	X-4	X-4
Denver Unit	7/1/86	7/86	X-4	X-4

Big Three Post 1987 12/3/84 - X-4 X-4

* Note: The Post 1987 Commitment is based on Price calculation of Commodity price of X-4 effective 1/1/88 Price adjusted on the 1st day of April, July October and January, in accordance with the following formula:

$$P = \frac{C_2}{C_1} \times P_1$$

P = Applicable price ($/MCF)

C_2 = Avg. Price BBL

C_1 = $ X-4

P_1 = X-4

Price Under [illegible] than X-4